

“Why the Deficit is Falling”

By Josh Bolten, Director of the Office of Management and Budget

Earlier this week, I reported to the President and Congress a dramatically improved picture for the Federal budget deficit. The budget deficit for 2005 is now projected to be \$333 billion, which is \$94 billion below February’s projection and represents 2.7 percent of the economy. At this level, the deficit would be smaller than the deficits in 15 of the last 25 years. We are well on our way to meeting the President’s goal of cutting the deficit in half by 2009, if not much sooner.

The reason for this improvement is that our growing economy is generating even greater revenue growth than projected just five months ago. Fueled by pro-growth policies, especially tax relief, the economy has grown by 12.4 percent since its lowest point in the 2001 recession.

Additionally, 3.7 million jobs have been created since May 2003, with the unemployment rate down to 5.0 percent. The unemployment rate is lower than its average level in the 1970s, 1980s, and 1990s, and inflation and interest rates have also remained low.

The tax relief proposed by the President and enacted by Congress in each year from 2001 through 2004 greatly contributed to this growth. It reduced income tax rates, encouraged small business investment, dramatically reduced the tax rate on dividends and capital gains, and phased out the death tax. Making this tax relief permanent will help keep our economic momentum going.

President Bush’s efforts to restore and sustain economic growth have included a commitment to spending restraint, which also is critical to meeting our deficit reduction goals. In each year of President Bush’s administration, he has worked with Congress to bring down the rate of growth in discretionary spending unrelated to defense and homeland security. His 2006 budget calls for an outright cut in such spending – the first proposed since President Reagan was in office.

The President’s budget proposed major savings and reforms in more than 150 government programs, not simply to reduce spending, but also to make sure taxpayers’ dollars are properly

focused on our priorities and on programs that are actually producing desired results. The House of Representatives embraced this concern in its appropriations bills, which endorse many of the President's reductions and reforms. Now Congress needs to follow through with the responsible spending restraint begun in the House.

Annually appropriated spending, however, accounts for only about 40 percent of the federal budget. We must also pursue policies that restrain the rate of growth in mandatory programs – programs that consume more than half of Federal spending now and are projected to consume an even greater percentage in coming decades. The President's 2006 budget proposed reducing the growth of mandatory spending by \$85 billion over five years. Congress committed in its budget resolution to seek \$35 billion of these savings, which means that for the first time in eight years, Congress plans to use its expedited procedures to reduce mandatory spending growth.

While continuation of the President's pro-growth economic policies and spending restraint should keep us ahead of pace to cut the deficit in half by 2009, we still face a longer-term challenge from the unsustainable obligations in entitlement programs. One of the most important of these programs, Social Security, will begin to face serious pressures in 2008 when the first Baby Boomers become eligible for benefits. In 2017, just 12 years from now, Social Security benefits will exceed payroll taxes, and the shortfalls will grow larger every year. By 2041, when workers now in their mid-20s begin to retire, the system will be bankrupt.

If we do not act now, the only solutions will be dramatically higher taxes, massive new borrowing, or sudden and severe cuts in Social Security benefits or other programs. The President has proposed reforms that would make the program permanently solvent while making Social Security a better deal for younger workers through voluntary personal retirement accounts. He has pledged to work with Congress to find the most effective combination of reforms to strengthen this critical program.

As the President's economic recovery plan was being implemented, some doubted the potential for his tax relief proposals to spur growth and job creation. The updated budget projections released earlier this week provide further evidence that this tax relief has been critical to our

success. Economic growth is back on track and, in addition to creating jobs, it is helping to reduce the deficit and improve our Nation's fiscal health.

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